

**SUMMARY OF MAJOR CHANGES TO  
DOD 7000.14-R, VOLUME 7B, CHAPTER 53  
“SURVIVOR BENEFIT PLAN (SBP) - TAXABILITY OF ANNUITIES”**

**Substantive revisions are denoted by a ★ preceding the section, paragraph, table or figure that includes the revision**

<b>PARA</b>	<b>EXPLANATION OF CHANGE/REVISION</b>	<b>EFFECTIVE DATE</b>
Complete chapter	Chapter 52 is redesignated as Chapter 53.	August 31, 1998
5301 through 5302 Bibliography	Clarifies mandatory withholding of federal income tax for one-time SBP payments.	January 21, 1999
5305 Bibliography	Updates the Internal Revenue Service address.	March 16, 1999

## CHAPTER 53

SURVIVOR BENEFIT PLAN (SBP) – TAXABILITY OF ANNUITIES5301 FEDERAL INCOME TAX

Survivor Benefit Plan annuities are taxable income subject to federal income tax withholding. A refund of cost resulting from an administrative error, correction of records, or the awarding of Dependency and Indemnity Compensation (DIC) is taxable to the annuitant. The member's retired pay tax status has no bearing on the taxability of the annuity payments or on the refund of cost. See subparagraph 530203.B, below, and Table 53-1 for exceptions to the taxability of SBP and Retired Serviceman's Family Protection Plan (RSFPP) annuities. SBP annuity payments are treated as "designated distributions" under Title 26, United States Code (U.S.C.), section 3405 (reference (dw)) for tax withholding purposes.

5302 FEDERAL INCOME TAX WITHHOLDING (FITW)

530201. Monthly or Periodic Payments. Monthly or periodic SBP annuity payments are treated as wages for federal income tax withholding (FITW) purposes. An annuitant, however, may elect no withholding of federal income tax. In the absence of an annuitant election, or if the annuitant does not otherwise submit a withholding certificate, the DFAS-Denver Center will withhold on the basis of "married, three exemptions." The annuitant may use TD Form W-4P or any substitute form furnished by the payer.

530202. Notice Requirements. The DFAS-Denver Center must advise the annuitant of the withholding requirement, and the right to elect that no tax be withheld, when making the first monthly or periodic payment to the annuitant. Thereafter, the DFAS-Denver Center must provide annual notice to the annuitant of the right to elect no withholding, revoke an election or submit a new withholding certificate. An annuitant also may submit a withholding certificate at any time to elect no withholding, revoke an election, or request any rate of withholding.

530203. Lump-sum (One-time) or Non-periodic Distribution Payments

A. SBP Cost Refunds. An SBP cost refund is a refund of premiums, rather than a distribution of benefits. As a non-periodic distribution, an SBP cost refund is subject to FITW at the rate of 10 percent. The annuitant, however, may elect no withholding of federal income tax. The annuitant has the right to make a FITW election for this refund separately from any election already in operation for all other SBP annuity payments.

B. Other. Lump-sum SBP annuity payments, other than the monthly or cost refund payments discussed above, are non-periodic distributions to the annuitant and subject to mandatory FITW at the rate of 20 percent. An annuitant may not elect no withholding of federal income tax. **EXCEPTION:** If the lump sum payment of an SBP annuity is the result of

administrative error or delay in the starting of an annuity, then the lump sum payment need not be treated as a payment subject to 20 percent FITW. Treat the payment as a periodic (or monthly) payment for tax withholding purposes (see paragraph 530201, above).

### 5303 INCOME EXCLUSION

530301. Consideration for Contract. The SBP annuitant is entitled to an income exclusion when, upon death of the participant member, the “consideration for contract” has been excluded in whole from the member’s gross income. After December 31, 1965, the member’s survivor who is receiving the annuity may exclude from gross income such annuity payments received until the total exclusion equals the portion of the “consideration of contract” not previously excluded from the member’s taxable income. The DFAS-Denver Center will accomplish the applicable direct reduction in taxable income for the annuitant and report the residual amount as taxable income on the annuitant’s Form 1099-R.

Example: When a member died on January 1, 1995, \$1000 of the total “consideration for contract” had not yet been excluded from the member’s non-disability retired pay. For 1995, the DFAS would have reported the taxable annuity less \$1000, and this reported residual amount would have been used by the surviving spouse in his or her income tax computation for the calendar year.

530302. Disabled Member’s Death Before Normal Retirement Age. In addition to the income exclusion allowed for “consideration for the contract,” the survivor of a member who retired because of a physical disability resulting from military service and died after September 20, 1972, but before August 21, 1996, before reaching normal “retirement age,” may exclude an aggregate of \$5,000 from taxable income on income tax returns. The survivor includes amounts in excess of \$5,000 in gross income. The DFAS-Denver Center should, upon request, provide the effective date of premiums, the total premiums paid (showing separate totals for deductions and direct remittances), the effective date, and amount of annuity.

530303. Direct Cost Payments. The tax-free benefit on SBP premiums is not available to members who waived military retired pay to receive disability compensation from the Department of Veterans Affairs (see paragraph 450602 of this volume). Instead, upon the member’s death, the annuity paid to the member’s survivor will be exempt from federal income tax until the amount excluded equals the total of the member’s direct cost payments.

### 5304 ADJUSTMENT TO TAXABLE ANNUITY

Reserved.

**5305 AMOUNT OF ANNUITY SUBJECT TO FEDERAL ESTATE TAX**

The value of the annuity at the time of the member's death may be subject to federal estate tax if any portion of the cost was paid by direct remittance, or if the value of the annuity exceeds the amount that may be excluded from the gross estate. The DFAS may furnish the annuitant the current annuity amount and/or a summary of annual payments, and total cost paid (separate totals for deductions and direct remittances). For a computation of the amount of an annuity that will be subject to the tax, if any, the executor of the member's estate may write to:

Internal Revenue Service  
Chief, General Actuarial Branch (OP:E:EP:A1)  
Room 2550  
1111 Constitution Avenue, NW  
Washington, DC 20224  
Telephone (202) 622-7789

**5306 STATE TAXATION**

The Form 1099-R information is furnished to the appropriate state tax authority regardless of whether SBP annuities are subject to state inheritance or income tax. The method of calculating such tax depend upon the laws of the state concerned.

**5307 FURTHER TAX INFORMATION**

Survivors should be advised that they may obtain further information concerning taxation of SBP annuities from the cognizant District Director of Internal Revenue or the cognizant state tax authority.

<b>TAXABILITY OF SURVIVOR BENEFIT PLAN/RETIRED SERVICEMAN'S FAMILY PROTECTION PLAN-NON-RESIDENT ANNUITANTS RESIDING OUTSIDE THE UNITED STATES</b>				
<b>R U L E</b>	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>
	<b>If the SBP annuitant resides in the country of</b>	<b>and</b>	<b>then the SBP annuity is</b>	<b>at the rate of</b>
<b>1</b>	Australia, Belgium, Cyprus, Egypt, Finland, France, Germany, Iceland, Korea, Morocco, Netherlands, Norway, Pakistan, Romania, Trinidad and Tobago, and United Kingdom	is a citizen of the country in which residing	not taxable (note).	
<b>2</b>	Italy	is an Italian national		
<b>3</b>		is not an Italian national	taxable	30 percent.
<b>4</b>	Spain	is a Spanish national	not taxable (note).	
<b>5</b>		is not a Spanish Italian national	taxable	30 percent.

Note: In order to claim entitlement to exemption from taxation based upon a tax convention or Treaty, a non-resident alien annuitant is required to file Treasury Form W-8BEN (Certificate of Foreign Status of Beneficial Owner for United States Tax Withholding).

**Table 53-1. Taxability Of Survivor Benefit Plan/Retired Serviceman's Family Protection Plan-Non-Resident Annuitants Residing Outside the United States**

**Chapter 53—Survivor Benefit Plan - Taxability of Annuities**

5301—Federal Income Tax	ASD Memo, December 8, 1990 26 U.S.C. 3405
5302—Federal Income Tax Withholding (FITW)	26 U.S.C. 3402(o)(3)
530201	26 U.S.C. 3405(a) (1), (2)
530203.A	26 U.S.C. 3405(b) (1), (2)
530203.B	26 U.S.C. 3405(c) DFAS-DE/GM Memo, July 23, 1998
5303—Income Exclusion	26 U.S.C. 101 26 CFR 1.122-1(d) Treasury Reg. 1-122-1(b)
530302	Public Law 104-188, section 1402(a), August 20, 1996